A Report
to the
Montana
Legislature

Financial-Compliance Audit

Teachers' Retirement System

For the Two Fiscal Years Ended June 30, 2010

December 2010

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Division

10-09A

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Tori Hunthausen, Legislative Auditor
Monica Huyg, Legal Counsel

Deputy Legislative Auditors
James Gillett
Angie Grove

December 2010

The Legislative Audit Committee
of the Montana State Legislature:

This report, along with our financial audit report (08-09B), constitutes our financial-compliance audit report on the Teachers' Retirement System (system), a component unit of the state of Montana, for the two fiscal years ended June 30, 2010. In both audits we tested compliance with laws that have a direct and material effect on the financial statements. This report contains no recommendations.

Our opinion on the system's financial statements is also contained in the Teachers' Retirement System annual report. The annual report contains additional background, statistical, and actuarial information not included in this audit report, which may be of interest to legislators or the public. Copies of the annual report are available at the Teachers' Retirement System or accessed on its website. The annual report for fiscal year 2010 is expected to be available in December 2010.

The system's written response to the audit is included at the end of the audit report. We thank the Executive Director and his staff for their assistance and cooperation throughout the audit.

Respectfully submitted,

/s/ Tori Hunthausen

Tori Hunthausen, CPA
Legislative Auditor

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Appointed and Administrative Officials

			Term Expires
Teachers' Retirement Board	Kari Peiffer, Chair	Kalispell	July 2012
	Darrell Layman, Vice Chair	Glendive	July 2011
	Scott Dubbs	Lewistown	July 2013
	Jeff Greenfield	Shepherd	July 2011
	Robert Pancich	Great Falls	July 2014
	James Turcotte	Helena	July 2015

Administrative Officials

David L. Senn, Executive Director

Tammy Rau, Deputy Executive Director

Dan Gaughan, Accounting Manager

For additional information concerning the Teachers' Retirement System, contact:

David L. Senn, Executive Director
1500 Sixth Avenue
P.O. Box 200139
Helena, MT 59620-0139
e-mail: dsenn@mt.gov

Montana Legislative Audit Division

Financial-Compliance

Teachers' Retirement System

For the Two Fiscal Years June 30, 2010

December 2010 | 10-09A | Report Summary

The Teachers' Retirement System has more than 18,950 active participants and approximately 12,400 retirees or beneficiaries are currently receiving benefits. In fiscal year 2010, $220 million were paid out in benefits to retirees or beneficiaries.

Context

The Teachers' Retirement System (system) is a component unit of the state of Montana. State law established the system in 1937. All full-time members of the public teaching profession, except for eligible employees of the Montana University System hired after July 1, 1993, are required by law to be members of the retirement system.

A six-member board governs the system. The board members each serve five-year terms. The Executive Director and system personnel are responsible for the daily administration of the system at June 30, 2010; the system had 16 full-time equivalent employees and is authorized for two more full-time equivalent employees.

Most system funding comes from employee and employer contributions and investment income. In fiscal year 2009-2010, these additions totaled over $430 million.

Results

The audit report does not have any recommendations.

The prior audit report had one recommendation concerning the actuarial unsoundness of the system. In order to be actuarially sound, the system must be funded to meet current year costs and amortize its unfunded liability in thirty years or less. The amortization period of the system as of July 1, 2009, did not amortize. As of July 1, 2010 the amortization period was 49.5 years. System Management intends to request legislation to address the prior recommendation. We make no further recommendation at this time.

Recommendation Concurrence	
Concur	0
Partially Concur	0
Do Not Concur	0
Source: Agency audit response included in final report.	

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Chapter I – Introduction

Introduction

We performed a financial-compliance audit of the Teachers' Retirement System (system) for the two fiscal years ended June 30, 2010. The objectives of our audit were to:

1. Determine if the system's financial statements present fairly, in all material respects, the financial position of the system and the results of operations at June 30, 2010.
2. Obtain an understanding of the system's controls to the extent necessary to support our audit of system's financial statements and, if appropriate, make recommendations for improvement in the internal and management controls of the system.
3. Determine if the system has complied with selected laws and regulations for fiscal years 2009 and 2010 and direct and material laws applicable to the financial statement presentation for fiscal year 2010.
4. Determine the implementation status of the previous audit recommendation.

Our financial audit of the system's financial statements for the fiscal year ended June 30, 2009, was issued in a separate report (08-09B). The financial statements are prepared by system personnel from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) with adjustment. Adjustments are made to accurately present financial activity.

This report contains no recommendations. Other areas of concern deemed not to have a significant effect on the successful operations of the system are not specifically included in the report, but have been discussed with management.

Background

The system is a component unit of the state of Montana. A component unit is a legally separate organization for which the state of Montana is financially accountable. The system, established by state law in 1937, had more than 18,950 active members not yet receiving benefits at July 1, 2010. Approximately 12,400 retirees or their beneficiaries were receiving retirement, disability, or survivor benefits as of July 1, 2010.

A six-member board, appointed by the Governor for five-year terms, governs the system. In addition to providing oversight to system personnel, the board's responsibilities include:

- Establishing rules and regulations necessary for the proper administration and operation of the retirement system.

- Determining the eligibility of a person who is applying for membership in the system.
- Designating an actuary to provide consultation on the technical actuarial aspects of the retirement system.

The Executive Director and system personnel are responsible for the daily administration of the system. At June 30, 2010, 18 full-time equivalent (FTE) positions were authorized for the system.

All full-time members of the public teaching profession, except for eligible employees of the Montana University System hired after July 1, 1993, are required by law to be members in the retirement system. All contributions are exempt from income tax to the employees until benefits are drawn against those contributions. Retirees are eligible for a Guaranteed Annual Benefit Adjustment (GABA) once they have received at least 36 monthly retirement benefit payments prior to January 1 of the year in which the adjustment is to be made. GABA provides eligible retirees with a guaranteed 1.5 percent increase in retirement benefits on an annual basis.

Prior Audit Recommendations

Our office performed the prior financial audit of the Teachers' Retirement System for the fiscal year ended June 30, 2009. The system conditionally concurred with the recommendation contained in the report. The recommendation has not been implemented.

The recommendation not implemented addresses the need for the system to take necessary measures to ensure the system is funded on an actuarially sound basis as required by the Montana Constitution. System management intends to request legislation to address this recommendation. We make no additional recommendation at this time. The recommendation is subject to review during the next audit.

Independent Auditor's Report

LEGISLATIVE AUDIT DIVISION

Tori Hunthausen, Legislative Auditor
Monica Huyg, Legal Counsel

Deputy Legislative Auditors
James Gillett
Angie Grove

Independent Auditor's Report

The Legislative Audit Committee
of the Montana State Legislature:

We have audited the accompanying Statement of Fiduciary Net Assets of the Teachers' Retirement System, a component unit of the state of Montana, as of June 30, 2010, and 2009, and the related Statement of Changes in Fiduciary Net Assets for each of the fiscal years then ended. The information contained in these financial statements is the responsibility of the Teachers' Retirement System's board. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Teachers' Retirement System as of June 30, 2010 and 2009, and its changes in fiduciary net assets for the fiscal years then ended, in conformity with accounting principles generally accepted in the United States of America.

Management's Discussion and Analysis, the Schedule of Funding Progress, and the Schedule of Contributions from the Employer and Other Contributing Entities are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements of the Teachers' Retirement System. The Supporting Schedule of Administrative Expenses, Schedule of Investment Expenses, and Schedule of Payments to Consultants are presented for purposes of additional analysis and are not a required part of the basic financial statements. Such information has

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been subjected to the auditing procedures applied to the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

At July 1, 2010, the Teachers' Retirement System was not actuarially sound. The amortization period for the Unfunded Actuarial Accrued Liability is 49.5 years. The maximum allowable amortization period is 30 years.

Respectfully submitted,

/s/ James Gillett

James Gillett, CPA
Deputy Legislative Auditor

November 5, 2010

Teachers' Retirement System
Management's Discussion and Analysis,
Financial Statements, Required Supplementary Information,
and Supplementary Information

TEACHERS' RETIREMENT SYSTEM
MANAGEMENT'S DISCUSSION AND ANALYSIS

The following discussion and analysis provides an overview of the financial activity of the Montana Teachers' Retirement System's (TRS) for the fiscal year ended June 30, 2010, with comparative totals for the fiscal years ended June 30, 2009 and 2008. Please read this in conjunction with the financial statements, accompanying footnotes, required supplementary information with notes, and supporting schedules.

Overview of the Financial Statements

Because of the long-term nature of a defined benefit pension plan, financial statements alone cannot provide sufficient information to properly reflect the System's ongoing plan perspective.

The financial section consists of two financial statements with footnotes, two schedules of historical trend information with footnotes, and three supporting schedules. The Statement of Fiduciary Net Assets reflects the resources available to pay benefits to retirees and beneficiaries. The Statement of Changes in Fiduciary Net Assets presents the changes that occurred in those resources for the fiscal year ended.

The Schedule of Funding Progress presents historical trend information about the actuarially funded status for the TRS plan from a long-term, ongoing perspective and the progress made in accumulating sufficient assets to pay benefits when due. The Schedule of Contributions from the Employer and Other Contributing Entities displays historical trend data of the annual required employer contributions and the actual contributions made by employers in relation to the requirement.

The Schedule of Administrative Expenses and the Schedule of Investment Expenses are a presentation of what comprises the administrative expense item and the investment expense item as reported on the Statement of Changes in Fiduciary Net Assets. The Schedule of Payments to Consultants represents our fees paid to outside professionals.

Financial Highlights

- Beginning July 1, 2009, the employer contribution rate increased from 9.47% to 9.85%.
- The TRS plan net assets increased by $221.0 million for 2010 following a decrease of $691.8 million in 2009, representing an increase of 9.5% and a decrease of 23.1%.
- Net investment income (fair value of investments plus investment income less investment expense) increased in 2010 by 148.1% representative of the positive rebound of the overall stock market and decreased in 2009 by 299.9%.
- Pension benefits paid to beneficiaries and plan members increased 4.9% and 7.0% for the last two fiscal years respectively.

Condensed Financial Information (in millions)

Fiduciary Net Assets	FY2010	FY2009	FY2008	2010 Percent Inc/(Dec)	2009 Percent Inc/(Dec)
Cash/Short-term Investments	$ 44.4	$ 25.5	$ 31.8	74.1	(19.8)
Receivables	24.0	22.6	29.5	6.2	(23.4)
Investments (fair value)	2,615.3	2,463.9	3,113.1	6.1	(20.9)
Capital Assets (net)	0.3	0.3	0.3	0	0
Total Assets	2,684.0	2,512.2	3,174.7	6.8	(20.9)
Liabilities	162.5	210.6	181.3	(22.8)	16.2
Net Assets	**$2,521.4**	**$2,301.6**	**$2,993.4**	**9.5**	**(23.1)**
Changes in Fiduciary Net Assets					
Additions:					
Employer Contributions	$ 72.2	$ 66.9	$ 67.9	7.9	(1.5)
Plan Member Contributions	62.8	57.3	59.6	9.6	(3.9)
Other Contributions	17.2	14.1	13.5	22.0	4.4
Net Investment Income	295.0	(613.0)	(153.3)	148.1	(299.9)
Total Additions	447.3	(474.8)	(12.3)	194.2	(3,760.2)
Deductions:					
Benefit Payments	220.2	209.9	196.1	4.9	7.0
Withdrawals	4.2	5.2	5.7	(19.2)	(8.8)
Administrative Expenses	1.9	1.9	1.8	0	5.6
Total Deductions	226.3	217.0	203.6	4.3	6.6
Net Inc/(Dec) in Net Assets	**$ 221.0**	**$(691.8)**	**$(215.9)**	**131.9**	**(220.4)**

Financial Analysis

- The change from year-to-year in cash/short-term investments is due mostly to the change in the number of shares held, a per share value of $1, in the Short Term Investment Pool.
- The increase in receivables for 2010 reflects the increase from 2% to 2.38% in the supplemental payment from the general fund. The decrease in receivables for 2009 represents a $2.4 million less in investment interest receivable and $4.5 million less in contributions due at fiscal year end.
- The increase in investments for 2010 represents the recovery in the economy and capital market conditions and the decrease in investments for 2009 is due primarily to the decline in the fair market value of our investment holdings.
- The significant fluctuation in liabilities is primarily due to the security lending collateral activity conducted by the Montana Board of Investments.
- The dramatic increase in net investment income for 2010 was due to an overall increase in the market value of our investment holdings. The significant decrease in net investment income in 2009 primarily reflected the continued decline in the fair value of investments of $435.5 million from the previous year.
- The increase in benefit payments from year-to-year reflects an increase in the number of retirees and beneficiaries plus the 1.5% guaranteed annual benefit adjustment.

Overview of the Actuarial Funding

The TRS plan experienced an asset gain over the last year. The market assets had a positive return of 12.87% net of investment and operating expenses. The actuarial assets earned 9.78% which is 2.03% above the actuarial assumption of 7.75%. Actuarial gains or losses result when the return on the actuarial value of assets differs from the actuarial investment return assumption. The following table compares the annual returns for the past six years.

Fiscal Year	Market Return	Actuarial Return	Actuarial Return over 7.75 %
7/1/2004 to 6/30/2005	8.04%	2.71%	(5.04)%
7/1/2005 to 6/30/2006	8.91%	8.46%	0.71%
7/1/2006 to 6/30/2007	17.64%	10.22%	2.47%
7/1/2007 to 6/30/2008	(4.88)%	7.18%	(0.57)%
7/1/2008 to 6/30/2009	(20.80)%	(10.26)%	(18.01)%
7/1/2009 to 6/30/2010	12.87%	9.78%	2.03%

The chart above shows that overall the actuarial return on assets has underperformed the assumption in the last six years. The 2007 Legislature increased funding contributions as noted below.

Contributions as a Percent of Pay

	Members	Employer Rate	State Contribution	Total
Prior to July 1, 2007	7.15%	7.47%	0.11%	14.73%
July 1, 2007 - June 30, 2009	7.15%	9.47%	0.11%	16.73%
July 1, 2009 and after	7.15%	9.85%	0.11%	17.11%

The State's General Fund picked up the increase in the employer rate of 2% effective July 1, 2007 and 2.38% effective July 1, 2009 in lieu of the contributions being paid by the school district and community college employers.

Section 19-20-201, MCA, requires the actuarial report to show how market performance is affecting the actuarial funding of the Retirement System. The July 1, 2010 market value of assets is $435.1 million less than the actuarial value of assets. If the market value of assets was used, the amortization period would be infinite, and the Funded Ratio would be 55.81%. Based on market assets, a contribution increase of 5.17% of pay (17.11% to 22.28%) effective July 1, 2011, is projected to maintain an amortization of the unfunded actuarial accrued liability over a 30 year period.

TEACHERS' RETIREMENT SYSTEM
A COMPONENT UNIT OF THE STATE OF MONTANA
STATEMENT OF FIDUCIARY NET ASSETS
JUNE 30, 2010 AND 2009

	2010	2009
ASSETS		
Cash/Cash Equivalents-Short Term		
Investment Pool (Note B)	$ 44,365,041	$ 25,485,799
Receivables:		
Accounts Receivable	19,916,535	14,319,630
Interest Receivable	4,110,813	4,840,668
Due from Primary Government	0	3,405,139
Total Receivables	$ 24,027,348	$ 22,565,437
Investments, at fair value (Note B):		
Mortgages	$ 16,342,528	$ 20,491,720
Investment Pools	2,426,072,098	2,222,769,923
Other Investments	10,826,623	10,511,607
Securities Lending Collateral (Note B)	162,097,378	210,084,770
Total Investments	$ 2,615,338,627	$ 2,463,858,020
Assets Used in Plan Operations:		
Land and Buildings	$ 193,844	$ 193,844
Less: Accumulated Depreciation	(150,545)	(147,409)
Equipment	142,697	63,662
Less: Accumulated Depreciation	(49,458)	(53,076)
Prepaid Expense	7,380	0
Intangible Assets, net of amortization	106,371	215,843
Total Other Assets	$ 250,289	$ 272,864
TOTAL ASSETS	$ 2,683,981,305	$ 2,512,182,120
LIABILITIES		
Accounts Payable	$ 111,324	$ 186,799
Due to Primary Government	0	16,891
Accountability for Advances	0	3,841
Securities Lending Liability (Note B)	162,097,378	210,084,770
Compensated Absences (Note B)	182,728	174,174
OPEB Implicit Rate Subsidy	144,155	96,974
TOTAL LIABILITIES	$ 162,535,585	$ 210,563,449
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS	$ 2,521,445,720	$ 2,301,618,671

The accompanying Notes to the Financial Statements are an integral part of this financial statement.

TEACHERS' RETIREMENT SYSTEM
A COMPONENT UNIT OF THE STATE OF MONTANA
STATEMENT OF CHANGES IN FIDUCIARY NET ASSETS
FISCAL YEARS ENDED JUNE 30, 2010 AND 2009

	2010	2009
ADDITIONS		
Contributions:		
Employer	$ 72,179,128	$ 66,850,644
Plan Member	62,844,529	57,256,365
Other	17,241,610	14,147,324
Total Contributions	$ 152,265,267	$ 138,254,333
Misc Income	$ 65,233	$ 15,421
Investment Income:		
Net Appreciation/(Depreciation) in Fair Value of Investments	$ 199,503,703	$ (671,926,498)
Investment Earnings	109,898,071	70,040,815
Security Lending Income (Note B)	1,253,635	4,318,004
Investment Income/(Loss)	$ 310,655,409	$ (597,567,679)
Less: Investment Expense	15,350,943	13,562,768
Less: Security Lending Expense (Note B)	349,935	1,897,208
Net Investment Income/(Loss)	$ 294,954,531	$ (613,027,655)
Total Additions	$ 447,285,031	$ (474,757,901)
DEDUCTIONS		
Benefit Payments	$ 220,193,357	$ 209,942,663
Withdrawals	4,165,835	5,170,028
Administrative Expense	1,905,124	1,853,873
OPEB Expenses	47,181	49,496
Total Deductions	$ 226,311,497	$ 217,016,060
NET INCREASE (DECREASE) IN PLAN NET ASSETS	**$** 220,973,534	$ (691,773,961)
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS BEGINNING OF YEAR	2,301,618,671	2,993,392,632
Prior Period Adjustment	(1,146,485)	
END OF YEAR	**$** 2,521,445,720	$ 2,301,618,671

The accompanying Notes to the Financial Statements are an integral part of this financial statement.

TEACHERS' RETIREMENT SYSTEM
A COMPONENT UNIT OF THE STATE OF MONTANA
NOTES TO THE FINANCIAL STATEMENTS
FISCAL YEARS ENDED JUNE 30, 2010 AND 2009

NOTE A. DESCRIPTION OF THE PLAN

The Teachers' Retirement Board is the governing body of a mandatory multiple-employer cost-sharing defined benefit pension plan, which provides retirement services to persons in Montana employed as teachers or professional staff of any public elementary or secondary school, community college, or unit of the university system. The system was established by the State of Montana in 1937 to provide retirement, death, and disability benefits and is governed by Title 19, chapter 20, of the MCA. TRS as an employer does not participate in the plan and acts only as the administrator of the plan.

At June 30, 2010, the number and type of reporting entities participating in the system were as follows:

Local School Districts & Coops	351
Community Colleges	3
University System Units	2
State Agencies	9
Total	365

At July 1, 2010, the date of the most recent actuarial valuation, system membership consisted of the following:

Retirees and Beneficiaries Currently Receiving Benefits	12,440
Terminated Employees:	
Vested	1,553
Non-vested	10,304
Current Active Members:	
Vested	11,961
Non-vested	6,992
Total Membership	43,250

The pension plan provides retirement, death, and disability benefits. Employees with a minimum of 25 years of service or who have reached age 60 with 5 years of service are eligible to receive an annual retirement benefit equal to creditable service years divided by 60 times the average final compensation. Final compensation is the average of the highest three consecutive years of earned compensation. Benefits fully vest after 5 years of creditable service. Vested employees may retire at or after age 50 and receive reduced retirement benefits. A Guaranteed Annual Benefit Adjustment (GABA) of 1.5% is payable each January if the retiree has received at least 36 monthly retirement benefit payments prior to January 1 of the year in which the adjustment is to be made.

NOTE B. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting

The TRS, a discretely presented component unit Pension Trust Fund of the State of Montana financial reporting entity, prepares its financial statements using the accrual basis of accounting. Employee and employer contributions are recognized as revenues in the period when due pursuant to statutory requirements and investment income is recognized when earned. Benefit and withdrawal payments are recorded in the period in which the liabilities are due and payable.

Compensated Absences

Compensated absences represent 100 percent of accrued vacation and 25 percent of accrued sick leave for TRS personnel at June 30, 2010 and June 30, 2009.

Cash/Cash Equivalents and Investments

The Montana Board of Investments (BOI) manages the State's Unified Investment Program, which includes the TRS plan investments as required by Section 19-20-501, Montana Code Annotated. Per the Montana Constitution, Article VIII Section 13(3), investment of TRS assets shall be managed in a fiduciary capacity in the same manner that a prudent expert acting in a fiduciary capacity and familiar with the circumstances would use in the conduct of an enterprise of a similar character with similar aims. Investments administered by the BOI for the TRS are subject to their investment risk policies. Information on investment policies, investment activity, investment management fees and a listing of specific investments owned by the pooled asset accounts can be obtained from Board of Investments at P.O. Box 200126, Helena, MT 59620-0126.

Information about the primary government's (State of Montana) investments, including credit risk classification, can be obtained from the Department of Administration, State Accounting Division, at P.O. Box 200102, Helena, MT 59620-0102.

Cash and cash equivalents consist of funds deposited in the State Treasurer's pooled cash account and cash invested in the Short-Term Investment Pool (STIP). Pooled investments other than STIP are reported at the fair value of each unit times the number of units owned. STIP is recorded at $1 per unit for each unit held. The fair value of publicly traded stocks and bonds is determined by reference to market prices supplied by State Street Bank (the custodial bank). Because a public market does not exist for private equity and real estate investments, the fair value of these investments is the value reported in the most recent external managers' valuation reports.

The TRS investments include: STIP; Retirement Funds Bond Pool (RFBP); Montana Domestic Equity Pool (MDEP); Montana International Equity Pool (MTIP); Montana Private Equity Pool (MPEP), Montana Real Estate Pool (MTRP), mortgages and real estate.

The TRS Investment Portfolio is listed below:

TRS Cash Equivalent and Investment Portfolio
June 30, 2010

Investment	Book Value	Fair Value
STIP	$ 38,081,160	$ 38,081,160
RFBP	673,872,463	710,013,885
MDEP	474,936,242	839,405,532
MTIP	334,585,518	415,264,157
MPEP	251,910,971	326,593,292
MTRP	193,814,000	134,795,233
Other Investments	27,158,428	27,169,151
Total	$ 1,994,358,782	$ 2,491,322,410

Securities Lending – Under the provisions of state statutes, BOI is authorized to lend its securities and has contracted with the custodial bank to lend the BOI securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. The custodial bank is required to maintain collateral equal to 102 percent of the fair value of domestic securities and 105 percent of the fair value of international securities while the securities are on loan. The BOI and the custodial bank split the earnings on security lending activities. The BOI retains all rights and risks of ownership during the loan period. The securities lending collateral, securities lending collateral liability, securities lending income, and securities lending expense consist of allocations to TRS on a pro rata basis of its ownership share of each pool with securities lending activity. At June 30, 2010, and 2009, the BOI had no credit risk exposure to borrowers because the collateral pledged by the borrowers exceeded the value of the securities borrowed. The private equity and real estate pools do not participate in securities lending.

Other Investments consist of a portfolio of Montana residential mortgages, an equity interest in four real estate properties, and Structured Investment Vehicles (SIVs).

The investment risks for the pooled investments that TRS participates in are described in the following paragraphs.

Credit Risk – Credit risk is defined as the risk that an issuer or other counterparty to an investment will not fulfill its obligation.

Custodial Credit Risk - Custodial credit risk is the risk that, in the event of the failure of the counterparty to a transaction, the BOI may not be able to recover the value of the investment or collateral securities that are in the possession of an outside party.

Concentration of credit risk – Concentration of credit risk is the risk of loss attributed to the magnitude of an investor's investment in a single issuer.

Foreign Currency Risk – Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment.

Interest Rate Risk – Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. In accordance with GASB Statement No. 40, the BOI selected the effective duration method to disclose interest rate risk.

All securities in pools are held in the name of the Montana BOI, or were registered in the nominee name for the Montana BOI and held in the possession of the BOI's custodial bank. MDEP, MTIP, MPEP, and MTRP do not invest in debt securities, so interest rate risk, credit risk, and concentration of credit risk do not apply to these holdings. According to GASB Statement No. 40, interest rate disclosures are not required for STIP since STIP is a 2a7-like pool.

The TRS investments subject to credit and interest rate risk at June 30, 2010 and June 30, 2009 are categorized below:

Investment		Fair Value 6/30/10	Fair Value 6/30/09	Credit Quality Rating 6/30/10	Credit Quality Rating 6/30/09	Effective Duration 6/30/10	Effective Duration 6/30/09
RFBP	$	710,013,885	662,541,761	NR	NR	4.08 yrs	4.08 yrs

MPEP, MTRP, MTIP, and RFBP include assets subject to foreign currency risk. The MPEP and MTRP investments in EURO currency had a carrying value of $27,140,768 and a fair value of $11,157,709 at June 30, 2010 and $22,918,330 and $9,967,018 at June 30, 2009. The MTIP and RFBP had cash and securities with a foreign currency value of $436,706,716 at June 30, 2010 and $$560,265,713 at June 30, 2009. The TRS position in those pools was approximately 38% for both 2010 and 2009.

NOTE C. CONTRIBUTIONS

The TRS funding policy provides for monthly employee and employer contributions at rates specified by state law. Plan members are currently required to contribute 7.15% of their earned compensation and the employer contribution rate for fiscal year 2010 was 9.85% of earned compensation. The State's General Fund contributed 2.38% of the employer contributions for school district and community college employers of their members earned compensation and an additional .11% of total earned compensation. Each employer in the Montana university system shall contribute to the TRS a supplemental employer contribution currently at a rate of 4.72% of the total compensation of employees participating in the Optional Retirement Program (ORP). An actuary determines the actuarial implications of the funding requirement in annual actuarial valuations. The actuarial method used to determine the implications of the statutory funding level is the entry age actuarial cost method, with both normal cost and amortization of the accrued liability determined as a level percentage of payroll.

NOTE D. FUNDED STATUS and FUNDING PROGRESS

Our most recent actuarial valuation may be accessed on our website at:
www.trs.mt.gov/Board/ActuarialValuations/ActuarialValuations

The funded status of the TRS plan as of July 1, 2010, the most recent actuarial valuation date is as follows (dollar amounts in millions):

Actuarial Value of Assets	Actuarial Accrued Liability (AAL)	Unfunded AAL (UAAL)	Funded Ratio	Covered Payroll	UAAL as a Percentage of Covered Payroll
$2,956.6	$4,518.2	$1,561.6	65.4%	$747.0	209.0%

The schedule of funding progress, presented as required supplementary information (RSI) following the notes to the financial statements, presents multiyear trend information about whether the actuarial values of plan assets are increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

Valuation date	July 1, 2010
Actuarial cost method	Entry age
Amortization method	Level percent open
Remaining amortization period	49.5 years
Asset valuation method	4-year smoothed market
Actuarial assumptions:	
Investment rate of return	7.75%
Projected salary increases	4.50%
Guaranteed annual benefit adjustment	1.50%
Inflation rate	3.50%

The actuarial valuation prepared as of July 1, 2010, the most recent valuation date, indicates the statutory rate is insufficient to fund the normal cost and to amortize the unfunded accrued liability under the entry age actuarial cost method over 30 years.

On a market value basis the TRS earned $843.7 million less than anticipated by the 7.75% assumption for the year ended June 30, 2009 and $116.1 million more than anticipated by the 7.75% assumption for the year ended June 30, 2010. The net result as of July 1, 2010 is that the market value of assets is $435.1 million less than the actuarial value of assets. This $435.1 million in unrecognized asset losses, if not offset by future gains, will cause the contributions needed to amortize the UAAL in future valuations to increase even further. Therefore, to remain financially sound in the future, TRS will need either (1) future gains such as asset returns greater than the 7.75% assumption, (2) an increase in contribution rates, (3) a reduction in liabilities, or some combination thereof.

NOTE E. OTHER POSTEMPLOYMENT BENEFITS

Plan Description

TRS employees and dependents are eligible to receive health care through the State Group Benefits Plan administered by the Montana Department of Administration (MDOA). In accordance with Section 2-18-704, MCA, the State provides optional post-employment medical, vision and dental health care benefits for retirees and their dependents and beneficiaries that elect to continue coverage and pay administratively established premiums. Plan coverage is on a calendar year basis. For GASB 45 reporting, the State Group Benefits Plan is considered an agent multiple-employer plan and TRS is considered to be a separate employer participating in the plan. Information about the State of Montana Other Postemployment Benefits (OPEB) can be obtained from the Department of Administration, State Accounting Division, at P.O. Box 200102, Helena, MT 59620-0102.

Funding Policy

The contribution requirements of plan members are established and may be amended by the MDOA. The monthly premium for plan members ranges from $260 to $916 for calendar year 2010 depending on the medical plan selected, family coverage, and Medicare eligibility. The plan is financed on a pay-as-you-go basis.

GASB 45 requires the plan's employers to report each year the annual required contribution (ARC), an amount actuarially determined in accordance with the parameters of GASB Statement 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover the normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years. The 2010 ARC is calculated for all the plan's employers and then allocated to each participating employer. The TRS 2010 ARC is $47,181 and is based on the plan's current ARC rate of 6.45% percent of total annual covered payroll for all employers. The 2010 ARC is equal to an annual amount required each year to fully fund the liability over 30 years. The amount of the estimated OPEB actuarial accrued liability was determined in accordance with GASB Statement 45, and the liability for TRS is estimated at $519,203. (The actuarial accrued liability is the present value of future retiree benefits and expenses.)

Annual OPEB Cost

For fiscal year 2010, the TRS allocated annual OPEB cost (expense) of $47,181 was equal to the ARC. The TRS annual OPEB cost, the percentage of annual OPEB cost contributed to the plan and the net OPEB obligation for 2010 and the two preceding years were as follows:

Fiscal Year Ended	Annual OPEB Cost	% of Annual OPEB Cost Contributed	OPEB Obligation
6/30/2008	$ 47,478	0%	$ 47,478
6/30/2009	49,496	0%	96,974
6/30/2010	47,181	0%	144,155

Funded Status and Funding Progress

The funded status of the TRS allocation of the plan as of January 1, 2009, the most recent valuation date was as follows:

Actuarial accrued liability (AAL)	$519,203
Actuarial value of plan assets	$ 0
Unfunded actuarial accrued liability (UAAL)	$519,203
Funded ratio (actuarial value of plan assets/AAL)	0
TRS Covered payroll (active plan members)	$764,771
UAAL as a percentage of covered payroll	67.89%

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. Actuarial calculations reflect a long-term perspective. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents multiyear trend information that shows whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

Projections of benefits for financial reporting progress are based on the substantive plan (the plan as understood by the employer and the plan members), and includes the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The projection of benefits for financial reporting purposes does not explicitly incorporate the potential effects of legal or contractual funding limitations on the pattern of cost sharing between the employer and plan members in the future.

Actuarial Methods and Assumptions

As of January 1, 2009, the TRS actuarially accrued liability (AAL) for benefits was $519,203, with no actuarial value of assets, resulting in an unfunded actuarial accrued liability (UAAL) of $519,203, and the ratio of the UAAL to the covered payroll was 67.89%. The UAAL is being amortized as a level dollar amount over an open basis for 30 years.

In the January 1, 2009, actuarial valuation, the projected unit credit funding method was used for the State. The actuarial assumptions included a 4.25% discount rate and a 2.50% payroll growth rate. The projected annual healthcare cost trend rate is 10.0% for 2009 and decreases by 1% per year down to 5% for 2014 and beyond for medical and 9.5% for prescription drugs decreasing a .5% to 2012 and then decreases by 1% down to 5% at 2015 and beyond.

TEACHERS' RETIREMENT SYSTEM
A COMPONENT UNIT OF THE STATE OF MONTANA
REQUIRED SUPPLEMENTARY INFORMATION

TRS PLAN
SCHEDULE OF FUNDING PROGRESS
(All dollar amounts in millions)

Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liabilities (AAL)[1]	Present Value of Future University Supplemental Contributions	Unfunded Actuarial Accrued Liabilities (UAAL)[2]	Funded Ratio[3]	Covered Payroll[4]	UAAL as a Percentage of Covered Payroll
July 1, 2005	2,497.5	3,527.0	126.2	903.3	73.4%	612.6	147.5%
July 1, 2006	2,745.8	3,733.6	124.7	863.1	76.1%	636.0	135.7%
July 1, 2007	3,006.2	3,928.5	153.4	768.9	79.6%	664.1	115.8%
July 1, 2008	3,159.1	4,110.8	157.1	794.6	79.9%	689.5	115.2%
July 1, 2009	2,762.2	4,331.0	157.2	1,411.6	66.2%	683.2	206.6%
July 1, 2010	2,956.6	4,518.2	158.7	1,561.6	65.4%	747.0	209.0%

(1) Actuarial present value of benefits less actuarial present value of future normal costs based on entry age actuarial cost method. Effective July 1, 2010, the System's AAL includes the present value of future university supplemental contributions.

(2) Actuarial accrued liabilities less actuarial value of assets and present value of future university supplemental contributions. Effective July 1, 2010, the System's UAAL is not offset by the present value of future university supplemental contributions. Instead, the ORP contributions are used as additional contributions toward the System's amortization of the unfunded liability.

(3) Funded Ratio is the ratio of the actuarial value of assets over the actuarial accrued liabilities less the present value of future university supplemental contributions. Effective July 1, 2010, the System's UAAL is not offset by the present value of future university supplemental contributions. Instead, the ORP contributions are used as additional contributions toward the System's amortization of the unfunded liability.

(4) Covered Payroll includes compensation paid to all active employees on which contributions are calculated.

TEACHERS' RETIREMENT SYSTEM
A COMPONENT UNIT OF THE STATE OF MONTANA
REQUIRED SUPPLEMENTARY INFORMATION

TRS PLAN
SCHEDULE OF CONTRIBUTIONS FROM EMPLOYERS AND OTHER CONTRIBUTING ENTITIES

(All dollar amounts in thousands)

Fiscal Year Ended	Annual Required Contribution	Percentage Contributed
June 30, 2005	57,150	100.0%
June 30, 2006	81,287	195.6%
June 30, 2007	96,228	117.1%
June 30, 2008	93,142	87.4%
June 30, 2009	80,998	100.0%
June 30, 2010	90,947	98.3%

A $50 million one-time contribution made by the State in FY 2007 and a $100 million one-time contribution made by the State in FY 2006 are included in the calculation of the percentage of ARC contributed.

Since the System is a Cost Sharing Multiple Employer Plan, there is no Net Pension Obligation (NPO).

TEACHERS' RETIREMENT SYSTEM
A COMPONENT UNIT OF THE STATE OF MONTANA
NOTES TO THE REQUIRED SUPPLEMENTARY INFORMATION

Actuarial Cost Method

The actuarial valuation was prepared using the entry age actuarial cost method. Under this method, the actuarial present value of the projected benefits of each individual included in the valuation is allocated as a level percentage of the individual's projected compensation between entry age and assumed exit. The portion of this actuarial present value allocated to a valuation year is called the normal cost. The normal cost was first calculated for each individual member. The normal cost rate is defined to equal the total of the individual normal costs, divided by the total pay rate.

The portion of this actuarial present value not provided for at a valuation date by the sum of (a) the actuarial value of the assets and (b) the actuarial present value of future normal costs is called the unfunded actuarial accrued liability. The unfunded actuarial accrued liability is amortized as a level percentage of the projected salaries of present and future members of the System.

The ultimate cost of any pension program over time equals the benefits paid and expenses incurred while administering the program. The source of revenue used to pay for this cost is equal to the contribution from employers and employees to fund the program, plus investment return earned on contributions made through pre-funding the benefit payments.

Valuation of Assets - Actuarial Basis

The actuarial asset valuation method spreads asset gains and losses over four years. The expected return is determined each year based on the beginning of year market value and actual cash flows during the year. Any difference between the expected market value return and the actual market value return is recognized evenly over a period of four years. The gains and losses are measured starting with the year ended June 30, 2007. The actuarial value of assets is not allowed to be greater than 120% or less than 80% of the market assets. (Adopted July 1, 2007)

Inflation Rate

The assumed inflation rate is 3.50% per annum, compounded annually (adopted July 1, 2004).

Investment Earnings

The annual rate of investment earnings of the assets of the System is assumed to be 7.75% per year, compounded annually. (Adopted July 1, 2004)

Guaranteed Annual Benefit Adjustment Increases

On January 1 of each year, the retirement allowance payable must be increased by 1.5% if the retiree's most recent retirement effective date is at least 36 months prior to January 1 of the year in which the adjustment is to be made.

Future Salaries

The rates of annual salary increases assumed for the purpose of the valuation include an assumed 4.5% annual rate of increase in the general wage level of the membership plus a variable merit

and longevity rate from 0% to 4.51%. The merit and longevity increases for the Montana University System (MUS) members did not show a pattern of increasing or decreasing with service at the time of our most recent study. Therefore, the MUS members have a flat 1% merit and longevity assumption. The general wage increase assumption was adopted July 1, 2004 and the merit and longevity scales were adopted July 1, 2002.

MUS members are assumed to have a 0.63% higher average final compensation to account for the larger than average annual compensation increases observed in the years immediately preceding retirement.

Amortization Method
The unfunded actuarial accrued liability created by this method, including gains and losses, is amortized as a level percentage of the System's projected payroll.

Amortization Period
The amortization period of the unfunded actuarial liability over an open period is 49.5 years as of July 1, 2010.

REQUIRED SUPPLEMENTARY INFORMATION
OTHER POSTEMPLOYMENT BENEFITS PLAN INFORMATION

Other Postemployment Benefits Plan Information
Schedule of Funding Progress

(All dollar amounts in thousands)

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) Entry Age (b)	Unfunded (UAAL) (b-a)	Funded Ratio (a/b)	Annual Covered Payroll (c)	UAAL as % of covered Payroll ((b-a/c)
1/1/2007	-	$ 449,321	$ 449,321	0%	$ 519,969	86.41%
1/1/2009	-	357,664	357,664	0%	526,794	67.89%

TEACHERS' RETIREMENT SYSTEM
A COMPONENT UNIT OF THE STATE OF MONTANA
SUPPORTING SCHEDULES
FISCAL YEARS ENDED JUNE 30, 2010 AND 2009

SCHEDULE OF ADMINISTRATIVE EXPENSES

Expenses for the administration of the plan, excluding compensated absences, depreciation and amortization, are budgeted and approved by the TRS Board. The administrative costs of the TRS are financed through realized investment income. The expenses, less amortization of intangible assets, may not exceed 1.5% of retirement benefits paid. Administrative expenses for the fiscal years ended June 30, 2010 and 2009 are outlined below:

	2010	2009
Budgeted Expenses:		
Personnel Services:		
Salaries	$ 832,848	$ 777,851
Other Compensation	2,200	3,900
Employee Benefits	255,300	239,816
Total Budgeted Personal Srvs	$ 1,090,348	$ 1,021,567
Operating Expenses:		
Contracted Services	$ 416,226	$ 423,789
Supplies & Material	26,890	47,488
Communications	56,833	44,231
Travel	16,267	23,556
Rent	62,931	61,139
Repair & Maintenance	40,178	35,390
Other Expenses	68,069	77,505
Total Budgeted Operating Exp	$ 687,394	$ 713,098
Non-Budgeted Expenses:		
Compensated Absences	$ 8,554	$ 15,499
Depreciation	9,356	7,841
Amortization of Intangible Assets	109,472	95,868
Total Non-Budgeted Expenses	$ 127,382	$ 119,208
Total Administrative Expenses	**$ 1,905,124**	**$ 1,853,873**

SCHEDULE OF INVESTMENT EXPENSES

Investment	BOI	Custodial Bank	External Managers	Total
STIP	$ 9,526	$ 3,929	$	$ 13,455
RFBP	200,887	141,685	322,617	665,189
MDEP	280,461	216,380	3,664,307	4,161,148
MTIP	279,485	81,696	1,788,704	2,149,885
MPEP	216,462	27,931	5,126,877	5,371,270
MTRP	182,231	15,225	2,713,580	2,911,036
Mortgages/Real Estate	53,610		25,350	78,960
	$ 1,222,662	**$ 486,846**	**$ 13,641,435**	**$ 15,350,943**

SCHEDULE OF PAYMENTS TO CONSULTANTS (included in administrative contracted services on previous page)

	2010	2009
Actuarial Services	$ 129,345	$ 104,511
Personnel Services	959	4,290
Legal Services	15,678	28,357
Medical Evaluations	700	1,450
Information Technology Services	58,360	80,760
Total Consultant Payments	**$ 205,042**	**$ 219,368**

Teachers' Retirement System

System's Response

TEACHERS' RETIREMENT SYSTEM

BRIAN SCHWEITZER, GOVERNOR

www.trs.mt.gov

STATE OF MONTANA

1500 EAST SIXTH AVENUE
PO BOX 200139
HELENA, MONTANA 59620-0139

1-866-600-4045
406-444-3134

November 22, 2010

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LEGISLATIVE AUDIT DIV.

Tori Hunthausen, Legislative Auditor
Legislative Audit Division
Room 160, State Capitol
PO Box 201705
Helena MT 59620-1705

Dear Ms. Hunthausen:

Thank you for the opportunity to reply to the Financial/Compliance audit report for the Teachers' Retirement System. The Teachers' Retirement Board appreciates the service that your office provides in reviewing the financial statements, and the internal controls and procedure of the Board.

The report contains no audit recommendations but notes that the prior audit recommendation, that the System take necessary measures to ensure the system is funded on an actuarially sound basis as required by the Montana Constitution, had not yet been implemented. The Board conditionally concurs with the recommendation on the basis that the Legislature needs to act on any proposal to actuarially fund the System. The Board has prepared legislation to address the funding of the retirement system and will continue to take every reasonable step necessary to ensure the system is funded on an actuarially sound basis.

Sincerely,

David L. Senn
Executive Director
406-444-3376

DLS/mm